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Going, going, gold

The pointlessness of holding bullion continues to sink in

The barbarous relic, as Keynes called it, is crumbling to dust. When even the venerable NM Rothschild has quit the gold market and the Bank of France, among the most stubborn of the official goldbugs, is thinking again about its bullion holdings, the end of gold as an investment has come a little closer.

It will not be before time. The fetishisation of shiny yellow metal, decades after it ceased to be used as the anchor of the international monetary system, is a lingering anomaly in modern financial markets. Perhaps Rothschild's last service to the bullion market could be to keep a live gold trader on display behind glass as a reminder of a bygone age, like the former coal miners who now make a living giving tours of defunct pits.

The one advantage of gold as a reserve asset is that, unlike assets based on fiat money, governments cannot make it worthless by inflating it away. But in an era of low inflation, and given that independent inflation-targeting central banks are the norm across the industrialised world, that risk has very sharply diminished.

Indeed, for both private and official investors, gold is now a rather risky asset with a nil or low return. The intrinsic value of gold, determined by its use in various industrial processes, is well below its market price. Gold does not grow. So its value to any one investor as an asset is dependent on other investors also holding it as an investment asset. The gold price hangs precariously by its own bootstraps.

For private investors to hold gold on this basis is their own foolish affair. For central banks and governments to hold it as a reserve asset is a betrayal of the public on whose behalf they are acting. Despite recent sell-offs, governments and central banks still hold about a fifth of the world's bullion. Their large holdings relative to the size of the market by themselves make gold particularly ineffective as a reserve asset: the very act of official selling of bullion on any large scale to raise cash will itself drive down the price.

This danger was amply demonstrated by the UK's unhappy experience of trying to sell some of its gold holdings. Announced in 1999 in a sensibly open and transparent fashion, the sales sparked such a fall in the global bullion price that a group of central banks signed a concord limiting such sales. That has recently been superseded by a new agreement providing for limited official sales.

Given the pointlessness of holding gold, the speed of its official sell-off scarcely matters, unless leaching the gold into the market bit by bit somehow maximises the return to the public purse by limiting the impact on the price. That would imply some irrationality on the part of the market. But then holding gold is irrational in the first place. Perhaps the central banks are right to go slowly.

Whatever the speed, the direction is clear. Gold is on its way out as an investment and a reserve asset. Three cheers for that.